FARM PRODUCTS AND COST ACCOUNTING

When a two-dollar price was promised for wheat it was inevitable that the output of other farm products should suffer. The farmers were going to produce more wheat, as was the purpose of the guaranty. But no great results were possible in the way of expanding the area of cultivated land or of increasing the number of farmers or of their hired men. Conscription for the army, and the draft of men to the war industries and to the other city industries that were suffering by depletion of man power, offered small prospect of stimulating the output of wheat except on terms of the restriction of other farm products. Wheat production was to be made so attractive as to divert farming enterprise away from other things to the growing of wheat. The other products were then certain to rise through the attendant restriction of their supply. What were still raised must promise as well as wheat, if wheat were not entirely to displace them. The prices for these other things had, then, to be higher, so far as these other things were produced at all. These prices in turn could be higher on whatever of them were produced only on terms of producing less of them.

This means that to raise the price on wheat was to increase the resistance to the supplying of other things. The larger output of wheat, by virtue of the higher prices offered, involved a restriction of the output of other things. Farmers must be paid higher prices for these other things—rye, potatoes, corn—so far as these other things should be available for consumption at all.

Is this to say, however, that the cost of production of these other things was increased? This must depend upon what one means by cost of production.

There is danger here of mixing economics and ethics, and, as always, with very considerable hazard to the economics. From the purely ethical point of view it is not clear that the farmer should have high prices on his milk, eggs, meat, and butter merely because he has been accorded a fabulous price for wheat. Ought not he to

be satisfied with his good fortune in wheat alone, and ask less rather than more for his milk and eggs and corn?

Quite possibly so—as ethics. The economic process does not work that way. The cost of production of any item of production is that minimum return below which the supply will be reduced, production restricted. As an economic category, cost is the necessary inducement. Therefore, to raise the price of certain farm products is to impose a higher price for all alternative products. This is merely another way of saying that it fixes a higher cost for these other products. In competitive undertakings, as a supply question, it is only through change in relative costs that there are changing relative volumes of product. When other products are withdrawn to make room for any given product, these others are withdrawn because of the higher costs attending the furnishing of them. It may have been well to offer unusual inducements for wheat. But the inevitable result was to increase the prices for the things that the raising of wheat displaced. This could take place only by raising the costs of the other things.

It is true that these other things came to involve no greater human pain, or strain, or stress of labor, no more sweat or backache, no more time. But the production of them met the intenser resistance of higher counterattractions. For all the purposes of supply as bearing on price, this was to impose higher costs. Cost from any other point of view is not to the purpose of the price investigation.

Economic costs, it must be clearly recognized, carry with them no ethical connotation. Price is the equating point between demand and supply. Cost bears on price only as it bears on supply. As a key to the supply side of the price equation, cost must indicate the price indemnity requisite to the bringing forth of a price product. Whatever influences increase this necessary indemnity are price-determining influences, contributions to cost, bearing through cost to modify supply, and bearing through a modified supply to affect the terms of sale on which the product is marketed—its market price. Thus the higher prices offered for wheat affect the prices of alternative products by affecting the supply of them. Inevitably this influence reports itself as an increase of cost. In

no other way could it limit the supply of alternative products and therewith increase the price of them.

But costs in accounting may be computed by other methods, as the problem may be this or that other problem outside of market price. Commonly the accountant is interested in cost as bearing on dividends. Any price debit against the total of price intake is, for the purpose of this sort of cost accounting, to be regarded as a cost; and nothing else is. Every balance carried over into the dividend account, every net gain to the enterpriser, is treated as a surplus above cost. The purpose of this accounting process being something else than the elucidation of the influences lying beyond supply and bearing through supply on the fixation of price, the meaning of cost is another meaning. Cost presents itself, therefore, as including only those subtractions that are to be made from gross receipts in order to record the net gains.

Is interest, then, also to be subtracted? Not for this purpose, excepting in cases where it is paid out. Returns credited to the proprietorship account are not included in cost. They are a remainder left over after costs have been subtracted. To compute for this purpose—the dividend purpose— interest on the value of the property as a cost would require that the interest charged be larger or smaller as the earnings of the property are larger or smaller, and thus could never, if the thing were accurately done, permit that any margin above cost remain. This accounting method for determining a surplus above cost would make any surplus impossible. If the earnings of the property, the interest rate accruing from it, are computed as costs, the bookkeeping will deny the presence of any earnings. The costs will equal the gross receipts, the debits balance the credits, this method of arriving at earnings leaving no earnings to be arrived at.

If, however, the accounting is organized solely from the point of view of the stockholders, it is possible to compute fixed charges as costs. This, to be sure, implies a denial of the corporate unity. It treats preferred stocks and bonds as debts owed by the common stock rather than as titles of proprietorship together with the

common stock. It views the different security holders, not as different classes of proprietors participating variously in the distribution of the earnings of their joint property, but, instead, regards the corporation as owned solely by one among the different classes of owners. But the method is still intelligible—and may serve its particular purpose. Actually, no doubt, there are significant conflicts of interest among the classes of claimants making up the aggregate ownership. For certain purposes, therefore, accounting may be organized to recognize these conflicts.

It is possible also that accounts be kept with a view, not to the determination of net earnings, but as a guide to one or another problem in business policy, for example the comparative earnings or efficiency for earning power of different departments. The content of the cost concept may be easily modified to suit the purpose in view. Thus it not rarely comes about that that interpretation of cost peculiarly appropriate to the economic problem of price may be adopted by the accountant in the solution of other problems. Is it wise for the business to maintain or to extend production in any particular line? This is not to be arrived at by charging up wages and machine hours and by apportioning rents, selling costs, and overhead charges in general to each particular product—a method reporting, as well as may be, whether the production is remunerative and in what degree—but only by arriving at an estimate of the net return in this particular direction compared with the returns possible in the production of some alternative product. If, for example, the farm accounts show that a particular field costing, say, \$10,000 yields \$1,000 of net gain in tobacco, it may still be bad policy to use the field for tobacco growing. What will it do in alfalfa or beans? Take it that a return of \$1,100 is possible in alfalfa, and \$900 in beans. Alfalfa is then the indicated product, tobacco and beans the displaced. In business terminology the accountant may report the crop as returning "profits" respectively of \$1,000, \$1,100, and \$900; but the inference is still that alfalfa must be the preferred crop. The tobacco displaces greater returns than it affords. In the economic sense, therefore, its cost must be computed at \$100

greater than the profit, the indemnity $100 short of the adequate, the displacement indefensibly great, the resistance overbalancing the inducement, and the cost outrunning the product.

How then does this line of analysis bear on the price to be accorded to the farmers for milk? Milk doubtless has been getting higher; but is it too high—not unjustifiably high as an issue of ethical costs, but too high relative to its economic costs in view of the quantity marketed? Even under conditions of acute shortage for the year's supply there is still no summer shortage for fresh milk. But milk has to be supplied for the year around. What is that winter price on which winter production and winter consumption are conditioned? Dairy farming calls for much labor, especially in winter. Wages are high; and if high-priced grains go into milk, the price of milk must be all the higher. High grain prices and high wages will not go with cheap milk; and especially must this be the case if meats also are high priced under the strenuous European demand and are tempting to the slaughtering of the herds. Meat and milk compete against grain—or the other way about. Milk must be restricted in supply. What there is will go to the consumers who will pay a high price for it, the price necessary to induce its production.

Thus far, I take it, the farmer's case is clear—as competitive business rather than as ethical issue. In the interest of the world's supply of food we have, it is true, been pleased to divert production to the luxury cereals and away from the cereals especially appropriate to a nation in a period of dearth. We fix some of the grain prices high, the wheat prices, in the hope that the farmer will follow suit in production. He does follow. Then we rave at him for the prices that go high on what is left of the things that we have been diverting him from producing. Facing the assumed necessity of more wheat in place of other farm products, we make the wheat high in order to get it, and so make the other products scarce as well as high—since high they must be, if consumers are not to buy them in place of the high-priced wheat; and then we follow with the appointment of commissions to see especially that the price of milk—itself another substitute for

cereals—shall be not less, and that even if less, the prices shall be not more.

Forthwith, however, the farmer urges that, despite the high prices on milk and in disregard of the need of grain, and especially, as we have arranged it, of wheat, for the assurance of which we have offered the high price, consumers shall maintain their old level of milk consumption—milk is so important a food for the babies—and the farmers would so much enjoy charging them a still higher price for it. True, it is the restricted supply of milk that imposes the high prices—one point for the farmer and a good one; and therewith the farmer urges that the consumer buy still more, so that the price may be still higher. But high prices restrict consumption—the consumer's sole point of reply. Here again, in truth, the issue is not ethical or need not be; but the milk producers would so present it.

The fact is that the general trend toward higher prices for milk and butter really report an increasing emphasis on a luxury food—a food required by the cities in a quantity that can be supplied by the tributary areas only on terms of rapidly rising costs and prices. New York, for example, consumes, we will say, 3,000,000 quarts of fresh milk daily. Time and refrigeration fix the shipment limit at from three to four hundred miles to the northwest. Other cities also draw supplies from the same area. To provide for this daily consumption the farmer has to produce intensively and at a high level of marginal costs—costs still further expanded at present by the high-pressure demand for alternative farm products. But in these agricultural areas especially well provided with rough and hill land for pasture, with only cows enough to furnish the necessary manure for general farming purposes and therefore with half his product of hay available for the city markets for hay, the farmer might produce half of his present output of milk at possibly half of its present price to him, especially during the summer period. But with the volume of output at the present level, with hay commanding $20 per ton, with the winter necessity for large outlays in high-priced western corn and southern cotton seed for stall feeding, and under the intensive conditions

of cultivation that are inevitable if 3,000,000 quarts of milk are to be delivered in New York alone—summer and winter—the price has to be high enough to offset the level of marginal costs imposed in the undertaking. And meanwhile the city fools urge that the price be lower—but the milk supply no less—and the country fools plead that the consumption be greater at a not lower price. Therewith the accountants do a variety of things. Mr. Hoover announces the suspension of the law of supply and demand, and things proceed in their established courses.

It is, however, not the less clear that as a question of economic cost—cost as the necessary supply price for the particular quantum of output—grain and hay must be computed by the farmer as cost items at the price that they will net him for sale, with subtractions made, of course, of the fertilizer value if fed out. What the hay and grain are worth to the farmer must be returned to him in the price of milk if he is to produce the milk. It is not to the point to urge that there is a profit in the grain or the hay at the market terms for them. The farmer will not forego this profit in order to furnish cheap milk, whether or not he ought. The consumer must pay for the milk if he is to get it. By the very title of this fact these items must rank as economic costs.

This, to be sure, is not the factory way of figuring costs; but —note again—factory costs are computed with reference to dividends and not with reference to the process of price fixation through the demand and supply equation of the market. The concern that is manufacturing steel as a step toward the marketing of rails may quite properly attribute no gain to the making of steel —excluding all steel profits from rail costs. Its business is the making of rails. The accountant's problem is therefore to determine the gain accruing through the unitary manufacturing process terminating in rails. Inasmuch as the enterprise is not in the business of selling steel, its gains do not accrue at the completion of the steel stage of the process. To keep the books in a way to allocate gains to steel would be so far to negative these gains for rails; and the business is rails. In its inventories also the steel must be reported, not at the price at which it would sell were it

going to be sold as steel, but rather at the cost at which it was made, because it is not going to be sold as steel. The gains, if any, accrue as conditioned on the selling price of rails and not on the selling price of steel. To inventory the steel at the market price for marketed steel is to record as accomplishment the substance of things hoped for—as actualities, the evidence of things yet to be seen, a failure not merely in rationality but still more in realism.

There are doubtless further problems in the market situation with reference to the costs and to the gains of the merchandizing and delivery companies. It may easily enough be true that the margins are overgreat; or the costs may be unduly high as a result of the competitive methods followed in small-piece dealings. I have intended to confine myself to an examination of the prices accruing to the farmer—the prices that must be paid to him if the present supply of milk is to be maintained. Possibly, however, something for the relief of consumers might be achieved through making the city merchandizing of milk a regulated monopoly. Still better, perhaps, though not in the direct relief of consumers, would be the adoption of the high-license principle—a method of concentrating the business through the eliminating of the major fraction of the competitive operators.[1] Appreciable revenues for the city treasury should accrue, without any appreciable increase in the price of milk to the consumers, possibly even with some, though probably an inappreciable, reduction of price. But it is at any rate clear that if the farmers are to keep up the present output of milk it must be on terms that are worth while for them, as against the other things that are open to them to do. Such is the essential meaning of cost for economic purposes and in economic problems.

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[1] It is significant in this regard to note that the margin for middleman charges in New York City, the spread between the city price to the producer and the delivery price to the consumer, is twice as large as in Philadelphia.